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Nos. 96-843 & 96-847

In The

Supreme Court of the United States

October Term, 1996

NATIONAL CREDIT UNION ADMINISTRATION,

Petitioner,

-and-

AT&T FAMILY FEDERAL CREDIT UNION and CREDIT UNION NATIONAL ASSOCIATION, INC.,

Petitioners,

vs.

FIRST NATIONAL BANK & TRUST CO., *et al.*,

Respondents.

On Writs of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF OF *AMICUS CURIAE* CALIFORNIA CREDIT UNION LEAGUE IN SUPPORT OF PETITIONERS

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CONSENT OF PARTIES

Petitioners and respondents have consented to the filing of this brief by *amicus curiae*.[1]

STATEMENT OF INTEREST OF THE CALIFORNIA CREDIT UNION LEAGUE

The California Credit Union League ("California League") is a nonprofit trade association representing the interests of 575 federal credit unions in the states of California and Nevada, comprised of over 5,391,590 members. The California League has represented federal credit unions in California since 1934.

Federal credit unions are nonprofit cooperative associations of individuals organized under the Federal Credit Union Act (the "FCUA" or "Act") "for the purpose of promoting thrift among [their] members and creating a source of credit for provident or productive purposes." 12 U.S.C. § 1752. Credit unions are formed by groups with common interests joining to pool their financial resources and thereby promote savings and provide reasonable rates of credit to their members. The majority of federal credit unions represented by the League consist of more than one employer group, and some have more than 400 separate employer groups. Congress encouraged the success of the credit union movement in order to bring financial services to people who were unable to obtain such services elsewhere and to foster the development of a system of financial cooperatives that would serve as a valuable alternative to the traditional for-profit banking system. Likewise, Congress created the National Credit Union Administration ("NCUA")

1. The consents have been filed with the Clerk of this Court. This brief was authored by the *amicus* and counsel listed on the front cover hereof, and was not authored in whole or in part by counsel for a party. No one other than *amicus* has made any monetary contributions to the preparation or submission of this brief.

as the federal agency charged with administration of the Federal Credit Union Act to ensure that these statutory purposes were accomplished, to ensure the safety and soundness of federal credit unions as an alternative credit system, and for the protection of credit union members.

Credit unions are organizations of people, not money. They are fundamentally different from other financial institutions. By definition, and as required by the Federal Credit Union Act, federal credit unions are nonprofit, member-owned and operated cooperative associations. By statutory requirement (as well as philosophical commitment), credit unions are democratically controlled with one vote for each member, regardless of the number of shares held by the member. Growth among credit unions is not for the purpose of greater profit for distant stockholders. Rather, growth for credit unions means first, continued viability in a heavily-regulated financial institution world, and second, more and better service for the individual member/owners who exercised the choice to participate in economic democracy.

The California League, then, is unusual among trade associations in that its true constituents are individual credit union members who have joined together in cooperative associations, rather than businesses. In a time when the nation as a whole is moving towards a model of greater self-reliance and nongovernmental mutual aid, credit unions provide an exemplary model of how citizens can join together to provide a high level of service for each other. The California League believes that a full understanding of the fundamental differences between credit unions and other financial institutions as developed since the FCUA's enactment in 1934 is a necessary background for an appropriate legal ruling by this Court. It is therefore on behalf of its 5,391,590 federal credit union members that the California League is interested in this case and submits this *amicus curiae* brief.

SUMMARY OF ARGUMENT

Credit unions are "democratically controlled, cooperative, nonprofit societ[ies] organized for the purpose of encouraging thrift and self-reliance among [their] members by creating a source of credit at a fair and reasonable rate of interest in order to improve the economic and social condition of [their] members." *La Caisse Populaire St. Marie v. United States*, 563 F.2d 505, 509 (1st Cir. 1977); *see* 12 U.S.C. § 1752(1). Credit unions are thus distinguished from other types of financial institutions by their cooperatively-owned, nonprofit nature and the statutorily mandated democratic control among member/owners (one vote per member, regardless of number of shares), which ensures a voice in the cooperative for small depositors or borrowers. In short, where banks and thrifts enter commercial relationships with their customers to generate profit, credit union members have a cooperative relationship whereby they provide financial services for their mutual benefit at no profit. Also unlike other financial institutions, a credit union does not serve the general public, but "members" (co-owners) of the credit union drawn from a particular, specified "field of membership." A credit union's field of membership consists of groups with common interests, or a "common bond."

Congress enacted the Federal Credit Union Act of 1934 to create and nurture a national credit union system. In the wake of the credit crash accompanying the Great Depression, Congress intended to create an alternative credit system to stabilize credit and economic conditions to promote the national public interest. This is plain and express in the terms of the statute itself:

> An Act to establish a Federal Credit Union System, to establish a further market for securities of the United States and to make more available to people of small means

> credit for provident purposes through a national system of cooperative credit, thereby helping *to stabilize the credit structure of the United States.*

The Federal Credit Union Act of 1934, Pub. L. 73-467, 48 Stat. 1216 codified at 12 U.S.C. § 1751 (emphasis added).

Congress' vision of a federal credit union system which provides a safe and sound alternative to other types of financial institutions so as to have a diversified credit finance structure in the United States has been (and continues to be) fulfilled. For example, in the wake of the savings and loan bailouts of the 1980s, Congress required its General Accounting Office ("GAO") to conduct a comprehensive study of the federal credit union system pursuant to the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA). Indeed, Congress ordered the GAO to conduct such a comprehensive study of all federally regulated financial institutions. The GAO's findings are unambiguous:

> The condition of today's federally insured credit unions is better than that of banks and thrifts. . . . [The National Credit Union Share Insurance Fund] NCUSIF reported equity of $1.25 for every $100 in insured accounts, as of December 31, 1990. GAO's preliminary estimate is that the Bank Insurance Fund's equity was no higher than $.26 per $100 in insured deposits as of that date.

GAO, Report to the Congress, *CREDIT UNIONS: Reforms for Ensuring Future Soundness,* 3 (1991).

The achievement of the current soundness of the federal credit union system was neither accidental nor automatic. Not

surprisingly, given the dramatic changes in the United States economy since 1934 and the natural (and expected) maturation process, credit unions have evolved from a nascent social movement to a mature system providing a variety of financial services to cooperative members on a nonprofit basis. This is precisely what Congress wanted and expected when it enacted the 1934 Act. Yet this gradual development of the federal credit union system to the most safe and sound of the existing financial institutions did not occur *ex machina* once Congress anointed it in 1934. To the contrary, the advancement of the federal credit union system to its present condition of safety and soundness was cultivated by both a concerned and committed Congress and responsible agency oversight. Indeed, the ups and downs of the nation's economic conditions required Congress to persistently adjust and refine its legislation governing all financial institutions. With respect to amendments of the FCUA, Congress has consistently expanded the scope of financial services which federal credit unions are authorized to provide.

The 1934 Act contained the following "common bond" provision:

> Federal credit union membership shall be limited to groups having a common bond of occupation or association, or to groups within a well-defined neighborhood, community or rural district.

12 U.S.C. § 1759. Congress did not define "common bond," nor has it modified the language of the common bond provision. Instead, Congress expressly entrusted to the NCUA the authority to interpret, develop and apply the provision as evolving economic and social conditions require. *See* 12 U.S.C. § 1754.

As part of its continuing efforts to "ensure the continued

availability of credit union service" and to ensure the soundness of the credit union system in light of the developing and maturing credit union system, the NCUA in 1982 adopted a policy permitting the establishment of credit unions consisting of "multiple occupational groups." Interpretive Ruling and Policy Statement ("IRPS") 82-1, 47 Fed. Reg. 16775 (Apr. 20, 1982). The policy permitted federal credit unions to amend their charters to accept employees from different occupational groups that do not share the same ownership, thus expanding the option to choose between different types of financial institutions for millions of citizens who were previously ineligible for federal credit union membership because they worked for a small or medium-sized employer.

Apparently precisely because Congress' vision of the federal credit union system as a viable alternate credit system has been achieved, First National Bank and Trust Company, Lexington State Bank, Randolph Bank and Trust Company, Bankers Trust of North Carolina, and American Bankers Association (the "Banks") have sued NCUA over its interpretation of the "common bond" provision of the Act.[2] The thrust of the Banks' lawsuit is that the NCUA's interpretation of this provision, to allow a single credit union to have members from more than one employer group, is contrary to the language of the FCUA and therefore unlawful. Both the lawsuit generally, and the Court of Appeals' decision in particular, misapprehend the nature and history of credit unions and the "common bond" principle as they pertain to congressional enactment of the FCUA and

2. The Banks concede — as they must — that the banking industry was not an intended beneficiary of the Federal Credit Union Act. Instead they claim standing through an asserted zone-of-interest analysis based on "competition." However, the Banks, representing assets of more than $5.5 trillion dollars, are steadily achieving greater and greater profits each year, realizing record profits of $52.4 billion in 1996, the fifth consecutive year profits continued to reach new heights. In contrast, the NCUA regulates credit union assets of approximately $200 billion, over 27 times less than the assets of the Banks. A true copy of FDIC documentation is attached as Appendix A.

empowerment of the NCUA.[3] As set forth more fully below, the history of the FCUA and the federal credit union system it generated and maintains demonstrates that Congress did not intend that the practical implementation of the term common bond remain unchanged despite the dynamic (and intended) growth of the federal credit union system. Accordingly, NCUA's reasonable interpretation of the provision, as the agency charged by Congress with enforcing the FCUA, should be upheld and the D.C. Circuit's judgment reversed.

ARGUMENT

I.

THE HISTORY OF THE FEDERAL CREDIT UNION ACT DEMONSTRATES CONGRESS' INTENT THAT A FEDERAL CREDIT UNION SYSTEM BE NOT ONLY ESTABLISHED BUT ALSO MAINTAINED AS AN ONGOING NONPROFIT, COOPERATIVE CREDIT ALTERNATIVE TO OTHER FINANCIAL INSTITUTIONS.

A. The Beginnings Of The Credit Union Movement.

Cooperative credit associations had their origins in mid-19th Century Europe. In Germany, Hermann Schulze-Delitzsch founded several cooperative credit societies. Schulze-Delitzsch emphasized that the collective liability incurred by members would motivate these societies to include only members deemed to be worthy of credit. Most of Schulze-Delitzsch's efforts were concentrated in urban areas and the size of his newly founded

3. The California League strongly believes that the Banks lack standing to sue the NCUA both because there is no injury in fact emanating from the statute challenged and no prudential standing. However, the scope of this brief is limited to the history of the federal credit union system and distinctions between credit unions and other financial institutions.

"people's banks" was often quite large. In the late 1800s, interest in cooperative credit associations began to grow in Canada and its first cooperative was organized there in 1901. J. C. Moody & G. C. Fite, *Credit Union Movement: Origins and Development, 1850 to 1980*, 3-25 (2d Ed. 1984).

In 1909, the first credit union in the United States, St. Mary's Parish Credit Union, was organized in New Hampshire. Just weeks later, Massachusetts passed the first state law authorizing state credit union charters, defining credit unions as cooperative associations "formed for the purpose of promoting thrift among [their] members." The field of membership of some early credit unions was quite broad. Indeed, St. Mary's Parish Credit Union essentially allowed anyone in the surrounding community to become a member. Although early state laws outlined the cooperative and democratic spirit of credit union philosophy, few restrictions, if any, were placed on membership. A. Burger & T. Dacin, *Field of Membership: An Evolving Concept*, 5 (1991) (study prepared by the Center for Credit Union Research and the Filene Research Institute).[4]

During the early twentieth century, credit unions grew under state charters. By 1934, there were approximately 2,500 credit unions in 38 states and Washington D.C. During this early period however, credit unions were not chartered or administered by the federal government.

B. Enactment Of The Federal Credit Union Act To Establish An Alternative National Credit System.

In 1934, Congress established a nationwide credit union system with the enactment of the Federal Credit Union Act. Pub.

4. Notably, as Burger and Dacin observe, "many of the early state credit union laws did not explicitly address the issue of common bond. It was simply left to the credit union to prescribe the qualifications, if any, for membership." *Id.* at 5.

L. No. 73-467, 48 Stat. 1216 (1934). Congress passed the Act in the wake of the collapse of the nation's credit markets during the Great Depression as part of the New Deal strategy to bring stability and security to financial institutions, as well as to the national economy more generally. At that time, funds available for loans became scarce and interest rates rose to high levels. *See* S. Rep. No. 555, 73d Cong., 2d Sess. 3 (1934). These high interest rates sharply reduced or eliminated the ability of individuals "of small means" to purchase goods on credit. *Id.* at 1. Prior to the passage of the bill allowing credit union organization in Washington D.C., government employees could only get credit through loan sharks. R. Bergengren, *Crusade*, 185 (1973). This was necessary because banks at that time did not lend to consumers. *Id.* at 26.

Congress determined that it was in the national public interest to "establish a Federal Credit Union System" that would "bring normal-credit resources on a cooperative basis to the masses of the people whose buying power is now so often dissipated in high-rate interest charges." S. Rep. No. 555, 73d Cong., 2d Sess. at 1; H.R. Rep. No. 2021, 73d Cong., 2d Sess. 1-2 (1934). Congress believed that a national credit union system would benefit small borrowers by providing them with an alternative to banks (who often would not lend small amounts of money to persons who could not meet the collateral requirements of the bank) and "loan sharks" (who charged usurious rates). *See, e.g.*, 78 Cong. Rec. 7259 (1934) (remarks of Sen. Sheppard); *id.* at 12224 (remarks of Rep. Luce).

Likewise, by permitting members "with their own money and under their own management to take care of their own short-term credit problems," credit unions were intended to improve substantially the terms on which small borrowers could obtain credit. S. Rep. No. 555, at 2. The buying power of the public would thus be directed toward the recovery of the nation's

economy, instead of being consumed by excessive interest charges. *Id.* at 1; H.R. Rep. No. 2021, at 1-2.

Congress was particularly impressed with the stability and financial soundness demonstrated by the credit union form of financial institution. As the Senate Report noted, in contrast to the upheaval the Depression caused the nation's banks, in the "38 States and in the District of Columbia" where credit unions operated, there had been "no involuntary liquidations" and credit unions had compiled an "exceptional . . . record for honest management." S. Rep. No. 555, at 2. *See also* 78 Cong. Rec. 7259 (1934) (remarks of Sen. Sheppard). It was from this social and economic context that Congress determined it to be in the national interest to establish a federal credit union system as an alternative credit system. Enacting the FCUA at this early time in the history of credit unions in the United States, Congress did not merely authorize the chartering of federal credit unions, but also affirmatively committed to the positive establishment and maintenance of an entire system of nonprofit federal credit unions as an alternative to profit-driven banks. In short, "Congress' general purpose was to encourage the proliferation of credit unions. . . ." *First Nat'l Bank & Trust Company v. National Credit Union Administration*, 988 F.2d 1272, 1275 (D.C. Cir. 1993).

Congress ensured that federal credit unions would be an alternative to for-profit banking through the structure it mandated for federal credit unions:

(1) Federal credit unions are funded by purchases of shares by *members only*, each member is an owner with the right to vote on credit union policies;

(2) Each member has only one vote, regardless of the number of shares owned by the member thereby ensuring the democratic nature and function of the federal credit union;

(3) Membership in a federal credit union is limited to "groups," the members of which share a "common bond" of occupation or association with each other or are located in a well-defined neighborhood, community or rural district;

(4) Overall, management of the credit union lies with volunteers; only one member of the board of directors is permitted to be compensated;

(5) Loans are made *exclusively* to members.

In addition, at the outset, the FCUA limited federal credit unions to making only small consumer loans.

This structure makes the distinctions with the for-profit banks and thrifts eminently plain. Whereas other financial institutions are capitalized by (and responsible to) *outside* stockholders, federal credit unions are by statute capitalized exclusively by member deposits. Whereas other financial institutions can sell services to the public at large, federal credit unions may provide financial services only to their own members. Whereas any bank or thrift director may be paid, only one federal credit union director may be compensated. And bottom line: banks and thrifts are driven by the desire for increasing profits;[5] federal credit unions seek to provide better and more reasonably priced services for the mutual benefit of the members.

5. A recent article from the American Bankers' Association newspaper, *Bankers News*, makes express the bankers' subordination of services to profit. In "Identifying and Wooing Your Best Customers," the ABA states candidly: " 'Between 50-60 percent of your customers are a burden; they're unprofitable. They're absorbing costs and they're not providing enough revenue to offset that cost,' says Hudson [EVP, First Security Bank, Salt Lake City], who advocates finding ways to develop their potential profitability." *Bankers News*, Volume 5, Issue 8, April 22, 1997. A true and correct copy of the article is attached hereto as Appendix B.

C. Congressional Expansion Of The Federal Credit Union System Since 1934 Demonstrates Its Intent To Maintain Federal Credit Unions As A Sound And Viable Alternative To Banks And Thrifts.

Since the 1934 enactment, Congress has responded to the evolving economic situation in the nation and consistently expanded the powers of federal credit unions through periodic amendments to the Act. To facilitate the growth and stability of the credit union system, Congress has given credit unions increasingly broad powers, and has repeatedly enacted legislation allowing them to offer additional services. In 1959, recognizing that some credit unions "hav[e] a large and continually increasing volume of loan activity," Congress authorized the appointment of loan officers, raised the unsecured loan limit from $400 to $1,000 and increased the maximum permissible loan maturity from 3 to 5 years. Pub. L. No. 86-354, 73 Stat. 628 (1959); H.R. Rep. No. 696, 86th Cong., 1st Sess. 55 (1959). In 1977, Congress expanded the lending authority of federal credit unions to permit credit unions additional powers in variable savings accounts, mortgage loans and consumer loans. Previously federal credit unions could offer only one type of savings account. Now they could offer variable rates and maturities for savings accounts and could offer share certificates (CDs). Also, in 1977, Congress authorized credit unions to make real estate loans with maturities of up to 30 years, to "allow credit unions to continue to be able to attract and retain the savings of their members." Pub. L. No. 95-22, 91 Stat. 49 (1977); H.R. Rep. No. 23, 95th Cong., 1st Sess. 7-9 (1977), *reprinted in* 1977 U.S.C.C.A.N. 105, 110-132.

Congress made these changes, and other similar expansions of credit union powers and services, with the express intent that credit unions be able to offer needed services, to attract new members and to retain current members. When Congress increased the maximum maturity of secured loans from 5 to 10

years in 1968, it did so to "enable credit unions to compete more effectively in the home improvement field . . ." S. Rep. No. 1265, 90th Cong., 2d Sess. 2 (1968), *reprinted in* 1968 U.S.C.C.A.N. 2469, 2470.

In October 1970, after 36 years of operating without any federal deposit insurance, Congress again amended the Act and made credit unions the last type of depository financial institution to obtain federal deposit insurance. The National Credit Union Share Insurance Fund ("NCUSIF") was established as a revolving fund in the U.S. Treasury, under the management of the NCUA. Unlike the FDIC or FSLIC, the NCUSIF was launched without any start-up capital from the U.S. Treasury or Federal Reserve, but was funded entirely by member credit unions. All federally-chartered credit unions were required to become members of the fund and state chartered credit unions could apply for membership in the fund.

D. Congressional Deregulation Of Financial Institutions In The 1970's And 1980's.

In the late Seventies and early Eighties, Congress enacted sweeping statutes aimed at deregulating financial institutions. These acts included the Federal Credit Union Act of 1977, the Financial Institutions Regulatory and Interest Rate Control Act of 1978, the Depository Institutions Deregulation and Monetary Control Act of 1980 and the Garn-St. Germain Act of 1982.[6]

6. It is a wonderment to the California League how, especially in light of these statutes which Congress specifically designed to promote competition between different types of financial institutions, the Banks can contend that they have suffered some kind of actual harm by the NCUA's interpretation of common bond. The Banks have access to the public at large; federal credit unions do not. Indeed, the competition the Banks must be concerned about is not head to head competition between a neighboring bank and credit union. Rather, it is the mere existence of the nonprofit credit union alternative that

(Cont'd)

The major intent of this sweeping financial reform was to enhance competition among depository institutions. Bundt & Keating, "Depository Institution Competition In The Deregulated Environment: The Case of the Large Credit Union," 20 *Applied Economics*, 1333 (1988).

With deregulation, Congress enabled federal credit unions to provide more services which previously were only available from banks and thrifts. Nevertheless, Congress maintained the fundamental structure and distinctions of the federal credit union system: credit unions were still nonprofit cooperatives which served only their own members.

E. Administration Of The Federal Credit Union Act To Promote Congressional Intent Of Proliferation And Soundness Of Credit Unions.

Congress enacted the FCUA, in large part, to establish an alternative credit system to stabilize the credit and economic conditions in the nation. To attain this congressional end, the statute would need to be administered with this goal front and center. Congress' intent to ensure both the proliferation and soundness of the federal credit union system is reinforced in the history of its delegation of powers to administer and interpret the Act.

Upon enactment, Congress initially charged administration of the FCUA to the Federal Credit Union section of the Farm Credit Administration. In 1942, Congress amended the FCUA and transferred its administration to the Federal Deposit Insurance Corporation. Six years later, it was assigned to the

(Cont'd)
upsets the Banks, the existence of which stands between the Banks and a monopolistic financial services landscape. Yet it is precisely the ongoing nonprofit alternative that Congress intended to create with the enactment of the FCUA.

Bureau of Federal Credit Unions within the Social Security Agency, under the Department of Health Education and Welfare, where it remained until 1970.

In 1970, Congress enacted the National Credit Union Administration Act whereby it established the NCUA as an independent federal agency charged with the administration and interpretation of the FCUA. P.L. 91-206.[7] The Senate Report describing the need for the legislation creating the NCUA as the independent administrator is unambiguous:

> Since their existence, the supervision and regulation of Federal credit unions has been shifted from one Federal agency to another. The current regulatory authority is vested in a bureau which is part of a larger (and to a great extent nongermane) administration which is a part of a still larger department of the Federal Government.
>
> *The committee believes that Federal credit unions have become such a significant component of our society that they need and deserve a more responsive and independent regulatory agency.*
>
> . . .
>
> The committee believes that the Federal instrumentality charged with the regulation of Federal credit unions has a great responsibility and an opportunity to make real and substantial contributions to our society.

7. In 1978, Congress created a three-member board to manage the agency. *See* Pub. L. No. 95-630, 501, 92 Stat. 3680 (1978); 12 U.S.C. § 1752a.

S. Rep. No. 91-518, 91st Cong., 2d Sess., 1970, P.L. 91-206, *reprinted in* 1970 U.S.C.C.A.N. 2480 (emphasis added).

As part of its responsibility for administering the Act, Congress specifically delegated to the NCUA the power to "prescribe rules and regulations for the [Act's] administration," and to charter, examine and supervise federal credit unions. 12 U.S.C. § 1766; *see generally,* 12 U.S.C. §§ 1756, 1754, 1753. Congress believed that by establishing the NCUA as an independent agency, it would improve the office's ability to "provide more flexible and innovative [credit union] regulation." S. Rep. No. 91-518, 91st Cong., 2d Sess., 1970, *reprinted in* 1970 U.S.C.C.A.N. 2481. A vital and express component of the NCUA's legislative mandate is to administer the Act so as to ensure the stability of federal credit unions. This is both consistent with and indicative of Congress' original intent to establish a federal credit union system as an ongoing alternative financial institution system. Congress also directed the President to "make certain that those selected for positions on the Board of Governors [of the NCUA] will have a deep interest in credit unions." H.R. Rep. No. 331, 91st Cong., 1st Sess. 5 (1969).

In 1972, the NCUA's administrator, Herman Nickerson, noted that "the number of federal credit unions dropped in 1971 for the first peace time year on record." NCUA, *Trends In Chartering And In Operating Credit Unions,* 6 (1973). Pursuant to its charge to ensure the stability of federal credit unions and protect their members, the NCUA undertook a study to determine the reasons for the decrease. The study revealed that several factors caused the change: impact of federal share insurance, broadening of membership field, economic factors, emphasis toward assisting existing credit unions and the dearth of volunteer officials. *Id.* at 5-10. Speaking to the emphasis on assisting existing credit unions, the study noted:

> Several respondents felt that a primary factor behind recent chartering trends has been a changing emphasis by most State Leagues away from organizing new credit unions and toward assisting existing credit unions. Undoubtedly the shifting emphasis is partly due to the numerous problems encountered by the many small credit unions in the 1960's. Many League officials express the opinion that *very small or marginal credit unions offer inadequate services to their members, and therefore add little or nothing* to the credit union industry. It is felt that, in many instances, *current and future credit union members can be best served by more stable and established credit unions.* The goal of increased credit union membership and service has not been altered, but the expressed emphasis is now on expanding membership and services of the successful credit unions rather than on increasing the number of units.

Id. at 9 (emphasis added). In response to the NCUA study, one regional director stated:

> We believe that fewer credit unions will be chartered than were chartered in past years. However, those organized will cover a larger field of membership and provide service to more people. Also, many groups not presently served will be reached by amending the charters of existing credit unions. . . . The services rendered should surpass the services

> provided by many of the credit unions which service relatively small groups.

Id. at 47.

As the NCUA study demonstrates, the credit union movement was at a point around 1970 where, due to economies of scale, it was of greater benefit to individual members that credit unions grow through increasing their field of membership (and mergers) rather than through organizing new small credit unions which were unable to provide the substantial services allowed by larger membership and larger credit unions.

In 1982 the NCUA further developed its field of membership approach by adopting a policy which expressly permitted the establishment of credit unions consisting of "multiple occupational groups." Interpretive Ruling and Policy Statement ("IRPS") 82-1, 47 Fed. Reg. 16775 (Apr. 20, 1982). The agency promulgated the policy in accordance with the provisions of the Administrative Procedure Act, after full opportunity for public comment. This policy permitted federal credit unions to amend their charters to accept employees from different occupational groups that do not share the same ownership, thus expanding the options to choose between different types of financial institutions for millions of citizens who were previously ineligible for federal credit union membership because they worked for a small or medium-sized employer. Subsequently, federal credit unions applied for amendments to their charters to add such additional employee groups consistent with this regulation and the language of the Act, under NCUA Chartering Manual Ch. 2 § I.

This evolution of the NCUA's policy was a considered and deliberate development of its administration of federal credit

unions, consistent with the statute[8] and required by conditions facing federal credit unions at the time. When the NCUA updated its policy in 1984, it specifically articulated the rationale for its 1982 decision to permit multiple group charters:

> The primary intent of the newly expanded field of membership policy and the essential basis for all changes in the policy since April 1982 is to provide credit union services to new groups — *to people who do not presently have credit union service available to them.*

49 Fed. Reg. at 467537 (IRPS 84-1) (emphasis added).

Despite the D.C. Circuit's statement below (Pet. App. A at 3), the NCUA's 1982 regulation expanding the definition of common bond was *not* an abrupt about-face from prior regulatory practices. To the contrary, as the federal credit union system developed and expanded in the years following 1934, the agency regularly adjusted field of membership requirements to correspond to existing needs as contemplated by the Act. For example, in 1967 NCUA's predecessor agency replaced its prior requirement that members be "extensively acquainted" with the

8. The D.C. Circuit below held that the NCUA's interpretation was contrary to Congress' unambiguous intent. Yet this holding of lack of ambiguity is directly contrary to the findings and recommendations of Congress' own GAO:

> If common bond is important to ensuring the safety and soundness of credit unions and distinguishing them from other insured depository institutions, legislative guidance should be provided on the purpose and limits of the common bond and multiple group charters.

GAO, *CREDIT UNIONS* at 214.

new requirement that members "know" each other. And in 1969, the agency amended its regulations to permit federal credit unions to have a "once a member, always a member" policy. Then in 1972, NCUA issued a chartering manual which described "common bond" as:

> a characteristic prerequisite to the fulfillment of group objectives and when present among persons of related interests and purposes, these persons could be expected to effectively operate a credit union.

See GAO, *CREDIT UNIONS* at 217. A revised chartering manual was issued in 1980. It further loosened the definition of common bond:

> Common bond is defined as the sharing of some unifying factor or characteristics among persons which simultaneously links them together and distinguishes them from the general public.

Id at 218. In this new chartering manual, the NCUA added new standard language for all types of common bonds that again relaxed the definition of "common bond:"

> Field of membership includes spouses of people who died while eligible for membership, employees of credit unions, members of their immediate family, and organizations of such persons.

The NCUA's history of adjusting its regulations in accord with the statute to provide for ongoing stability and soundness in the credit union system demonstrates the Agency's adhering to congressional intent, rather than thwarting it.

II.

THE CREDIT UNION MOVEMENT DEVELOPED THE TERM "COMMON BOND" AS A PRINCIPLE FOR ORGANIZING CREDIT UNIONS AS VIABLE FINANCIAL INSTITUTIONS.

Congress did not coin the term "common bond" in the 1934 FCUA. Neither did it fix a single, set definition which it intended would remain unchanged throughout the development of the federal credit union system. *See generally,* 12 U.S.C. §§ 1751 *et seq.* To the contrary, the term was taken from the emerging credit union movement itself. Early leaders of the credit union movement in the United States identified a commonality of interest, or "common bond" as being a sound *basis* of credit union membership and organization. A. Burger & T. Dacin, *Field of Membership: An Evolving Concept,* 5 (1991)

Professors Burger and Dacin explain the economic function of the common bond principle:

> The common bond was a low cost way of delivering specific services to a specific segment of the financial market. Credit unions had a focused market — small loans to consumers. . . . [¶] Providing small consumer loans is very costly. The cost of originating the loan — credit checks, paper work, etc. and enforcing and collecting the loans is very high. It is expensive to collect valid financial information on the loan applicant, especially before the advent of central credit agencies. Collecting monthly payments incurs mailing and record keeping costs. Also, the costs of collecting bad loans is very high involving finding the individual

and related legal fees. In addition, the cost of processing of a $5,000 loan for a three-year period is generally the same as the fixed costs associated with originating a $200 loan for a three-month period. For example, collection and information costs were estimated at $62.12 or 53.1% on a $200 loan in the early 1970's. M. Flanery, *An Economic Evaluation of Credit Unions in the United States*, 61 (1974). Given these high costs, banks were not very interested in this business and credit unions found that their main competitors, especially in the urban industrial areas, were loan sharks.

Credit unions were able to significantly reduce the costs associated with originating small consumer loans through the use of a common bond among the members and a restricted field of membership. For example, occupational credit unions had low-cost knowledge of the income, character, and job stability of potential borrowers. Peer pressure acted to reduce default rates, and credit unions took a more "personal" approach to working out loan difficulties with their members.[9] Close ties of lenders and borrowers, and boards of directors who understood the local economic conditions, the "character," and the financial position of

9. Loan losses for all federal credit unions amounted to 0.32% of the dollar amount of these loans compared to 0.43% for commercial banks and 2.38% for finance companies (5 year averages ended 1974). Peggy Brockschmidt "Credit Union Growth in Perspective," *Monthly Review* (February 1977).

the borrower, made it economically feasible to provide these small loan services to individuals who would not otherwise have access to financial markets.

. . .

Organizing new credit unions was simply much easier around particular groupings. It was also more economically viable to found credit unions in industrial groupings where start-up costs were generally lower due to the presence of an established infrastructure and a ready supply of volunteers. A small credit union was easily managed by unpaid volunteers, who ran most of the credit unions. Data processing was by ledger, and the optimal size was seen by many early credit union founders to be under 500 members. . . .

Id. at 6-7.

In contrast, the federal credit union system is no longer in its "early days." To the contrary, it is now a mature, well developed credit system wherein growth through expansion of field of membership is consistent with and fulfills Congress' original intent to develop a sustainable alternative nonprofit credit system. There is nothing in the Act to suggest otherwise.

III.

FEDERAL CREDIT UNIONS CONTINUE TO OPERATE AS AN ALTERNATIVE, NONPROFIT SYSTEM OF CREDIT DISTINCT FROM OTHER FINANCIAL INSTITUTIONS AS ENVISIONED BY CONGRESS.

Congress designed the federal credit union system as an alternative credit system separate and apart from other federally regulated financial institutions. The impetus was twofold: (1) existing credit unions survived well the onslaughts of the Great Depression without the wholesale closures experienced by banks; and (2) credit unions were nonprofit institutions serving individuals of "small means" who were not being served by other financial institutions. These motivations and credit unions' distinctness as a financial institution remain today.

As a result of congressional deregulation of financial institutions in the 1970's and 1980's, different types of financial institutions provide increasingly similar types of *consumer* services.[10] Nevertheless, the need for the federal credit union system as initiated by the 1934 Act remains. Federal credit unions still provide financial services at a lower cost to the consumer than do banks and thrifts. Analysis of the Bank Rate Monitor dated April, 1996, reveals that credit unions had dramatically lower interest rates on consumer loans than did banks: for cars, banks charged an average of 9.14%, compared to 7.71% at credit unions, and credit card interest at banks averaged 18.18%, compared to 13.15% at credit unions. Credit unions offer greater savings incentives, as well, averaging .75% greater interest yield than banks. *Id.* The lower interest rates for

10. Although by deregulation Congress expanded federal credit union powers for consumer financial products, federal credit unions are still restricted to providing consumer services. Banks remain the primary institutions providing commercial financial services.

loans found in credit unions are not based upon a desire to "outcompete" the Banks, but are a natural byproduct of the nonprofit structure of the credit unions. Without stockholders to please, the credit unions set their rates based upon ability to cover expenses and pay interest back to their members. In addition, the FCUA requires that credit unions make loans for "provident and productive purposes." 12 U.S.C. § 1752. The Banks have no similar limitation or recommendation.

Safety and soundness issues also distinguish federal credit unions from banks and thrifts and embody the continued fulfillment of congressional intent. As determined by the congressional GAO, the condition of the federal credit union system is "better than that of banks and thrifts." GAO, *CREDIT UNIONS* at 3. In 1989, the insurance fund for thrifts went bankrupt, with a loss of approximately $200 billion. Similarly, the bank insurance fund had a negative net worth. Kane & Hendershott, *The Federal Deposit Insurance Fund That Didn't Put a Bite on U.S. Taxpayers*, 20 JOURNAL OF BANKING & FINANCE 1305, 1306 (1996). Conversely, the credit unions' insurance fund, NCUSIF, funded solely by member credit unions and managed by the NCUA, remained solvent, despite the fact that it, too, "was exposed to managerial turnover, unlucky economic events, a strong lobby, and financial deregulation." *Id.* at 1307. This success can be explained by the cooperative form of credit unions, which "lessens personal returns that can be captured by managers who successfully shift risks to NCUSIF" and reflects "difficulties managers face in diverting to themselves a sizeable share of the upside of the firm's winning bets." *Id.*

Further, NCUSIF is funded differently from the thrift and bank insurance funds:

> Establishing this fund of prepaid premiums aligns the incentives of bureaucrats,

> politicians, and credit unions to restrain NCUSIF loss exposure better than the pay-as-you-go systems used by the other two federal funds. Because the impact of individual institution failures on CUMIS premiums and NCUA assessments is averaged across surviving credit unions, credit-union managers have an incentive to alert private and federal monitors to instances of corrupt, incompetent, or highly speculative activity at other credit unions when they learn of them.

Id. at 1313. In sum, the cooperation runs deeper than just members of a single credit union — the entire federal credit union system collectively coinsures and is jointly responsible for the success of each credit union, because if one fails, the rest of them pay. The same clearly cannot be said to apply to for-profit institutions.

Finally, when a credit union requests an amendment to its charter to add a group, the reasons may include:

- Providing credit union access and service to an additional, clearly defined group of persons who desire to be served by the applicant credit union;
- Diversifying the membership base in order to withstand real or potential economic adversities;
- Expanding the membership base to facilitate *an improvement of service* to all members.

Chap. 2, "Reasons for Requesting an Amendment." (Emphasis added.) This evidences an intent to expand only when

specifically desired by the members of a potential group, to economically survive, or to better accommodate members — all permissible objects from the service-oriented, and financial stability goals of the 1934 Act. Further, the request for adding a group must indicate: "That at present the group does not have the availability of a credit union." *Id.* Again, these requirements illustrate only the furthering of Congress' original credit union goals: to make reasonably-accessible credit available to all groups who desire it — any other policy would frustrate these clearly-defined purposes of the FCUA. Expanding into areas previously unserved, when specifically requested to do so, cannot be construed as competition with banks, who are virtually unrestrained in their ability to solicit any customer residing anywhere. These two entirely different ways of extending credit are simply not comparable.

CONCLUSION

Both by its original enactment of the Federal Credit Union Act and by its subsequent amendments expanding the powers of federal credit unions, Congress has unambiguously demonstrated its commitment to maintaining the nonprofit federal credit union system as a consumer alternative to for-profit banks and thrifts. The GAO's 1991 Report To Congress heralding the federal credit union system as the most sound of the financial systems illustrates the responsible and effective administration of credit unions by the NCUA. The California League's constituents count among their members teachers, factory workers, firefighters, clerical workers, government employees; indeed, the entire gamut of working people. Patently there is nothing in the 1934 Act (or anywhere else in the record) to show that Congress sought to deprive any one of these groups the opportunity to choose to become a member of a federal credit union and avail itself of the benefits of nonprofit financial services. Insofar as nothing in either the 1934 Act or subsequent

amendments demonstrates a clear congressional intent to cripple credit unions by requiring the "common bond" provision be interpreted restrictively, under *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), this Court should permit the NCUA's common bond regulation to stand and reverse the circuit court below.

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Respectfully submitted,

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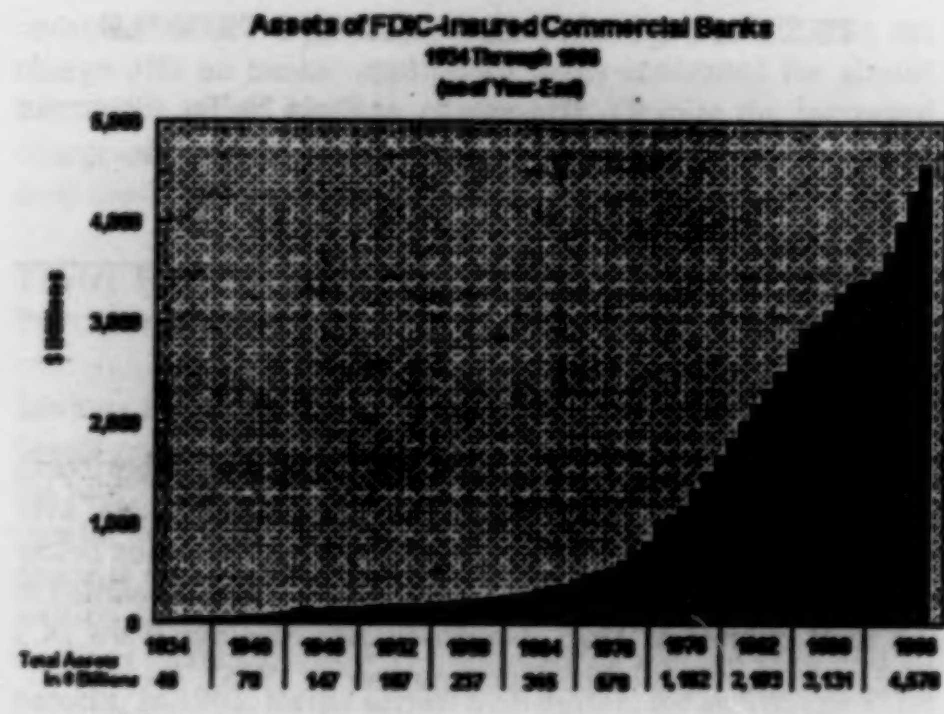
APPENDIX A — FDIC DOCUMENTATION



A-3

THE FDIC QUARTERLY BANKING PROFILE

Ricki Helfer, Chairman

Graph Book — Fourth Quarter, 1996

Fourth Quarter Highlights

Fourth-Quarter Bank Earnings Total $13.7 Billion

Insured commercial banks earned $13.7 billion in the fourth quarter of 1996, the third-highest quarterly earnings total ever reported. The industry's net income was only $91 million below the all-time quarterly record amount of $13.8 billion, earned in the third quarter of 1995. Fourth-quarter earnings were 14.5 percent higher than in the fourth quarter of 1995.

Full-Year Earnings Set New Record For Fifth Consecutive Year

For all of 1996, insured commercial banks earned a record $52.4 billion, an increase of $3.6 billion (7.5 percent) over 1995. This is the first year that industry earnings have surpassed $50 billion. The average return on assets (ROA) was 1.9 percent, the second-highest annual level ever recorded, and only slightly below the all-time high of 1.20 percent, set in 1993.

Problems Increase In Consumer Loans, Decline In Other Categories

Higher charge-offs helped produce a decline in noncurrent loans (loans 90 days or more past due or in nonaccrual status) during 1996. Much of the increase in charge-offs was centered in

consumer loans, especially credit cards. For the full year, net charge-offs on banks' credit-card loans accounted for almost two-thirds of all net loan charge-offs. Despite the increased charge-off activity, noncurrent and delinquent (30-89 days past due) credit-card loans rose during 1996.

Thrift Industry Earnings Rebound From Net Loss In Previous Quarter

Savings institutions posted net earnings of $2.2 billion in the fourth quarter, an increase of $375 million (21 percent) over the fourth quarter of 1995. The higher earnings followed a third quarter in which a $3.5-billion special assessment on SAIF deposits combined with extraordinary losses to produce a $56-million net loss for the industry. For the full year, industry earnings totaled just over $7 billion, for an average ROA of 0.70 percent. In 1995, thrifts earned $7.6 billion, for an average ROA of 0.77 percent.

Six Insured Institution Failures Is Smallest Annual Total Since 1972

No insured commercial banks or thrifts failed in the fourth quarter. For all of 1996, there were six failures — one savings institution and five commercial banks. This is the fewest failed institutions since 1972, when five institutions — two FDIC-insured commercial banks and three FSLIC-insured savings institutions — failed. In 1995, there were eight insured institution failures — two savings institutions and six commercial banks.

Appendix A

Reserve Ratios For Both Insurance Funds Rise Slightly In Fourth Quarter

The reserve ratios for both the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF) increased modestly in the fourth quarter. The increases occurred despite lower insurance premium revenues, due to the combination of higher investment earnings and the absence of insurance losses. Both insurance funds met the minimum reserve ratio requirement of 1.25 percent of insured deposits the beginning of the fourth quarter, after the SAIF became fully capitalized on October 1.

APPENDIX B — *BANKERS NEWS* ARTICLE

IDENTIFYING AND WOOING YOUR BEST CUSTOMERS

TO PARAPHRASE NAPOLEON THE PIG'S FAMOUS RULE in George Orwell's classic "Animal Farm": All bank customers are equal, but some customers are more equal than others.

That line probable best summarizes the results of a recent bank profitability distribution study done by the First Manhattan Consulting Corp., New York.

According to Utah banker Phil Hudson, whose bank was included, the study shows:

Generally, 20 percent of households represent the bulk (80-90 percent) of a bank's profitability.

This 20 percent, which encompasses all income levels, is subsidizing the rest of your customers.

"Between 50-60 percent of your customers are a burden; they're unprofitable. They're absorbing costs and they're not providing enough revenue to offset that cost," says Hudson, who advocates finding ways to develop their potential profitability.

The results of the First Manhattan Consulting Corp.'s study mirror many others done by banks of all sizes throughout the country, including a five-year examination of his own holding company, says Hudson, EVP, First Security Bank, Salt Lake City.

The data from those studies underline the need for community bankers to do a better job of allocating their resources to focus on the most profitable customers and increase their share of those "A" customers' wallets, he says.

Saying that 20 percent of bank customers account for 80 percent of the profits may even understate the situation, consultant Robert Hall told the ABA/BMA National Conference for community bankers in Orlando, Fla.

"In over 7,000 market analyses, we consistently find that 3 to 5 percent of the customers are generating half of the profits," says Hall, CEO, ActionSystems Inc., Dallas, and author of "The Streetcorner Strategy for Winning Local Markets."

Knowing who those customers are and building a fence around them is critical, Hall says.

"We have found . . . that on average in a local trade area the ability to do a better job of targeting your profitable customers and your high potential customers and direct more effort toward them is worth somewhere around $75,000 to $90,000 per local branch," he adds.

How do you determine who those high-profit customers are at your bank?

That capability is available at reasonable costs even at the smallest banks, Hudson says.

"There are a number of vendors who will accept [customer data] tapes and do a profitability study for you," he says.

Hudson adds that the pricing of marketing customer information file systems — MCIFs — also has dropped, and says their potential payoff is immense.

The problem with trying to identify your most profitable customers without outside help or an MCIF is that traditional segmentation schemes such as age, education and income demographics are not reliable.

"Upscale customers aren't necessarily the most profitable. There are as many upscale customers in the unprofitable [customer segments] as the profitable ones," Hudson says.

In fact, all income levels are found in both the profitable and unprofitable segments, he says.

ATTITUDES AND BEHAVIORS

There are, however, distinctive attitudes and behaviors that seem to identify profitable customers:

- Such customers tend to keep a lot of money in the bank.

"If you don't have an MCIF, you can use deposits as a proxy for profitability," Hudson says.

"The top 20 percent probably will represent close to 90 percent of your deposit base in almost every one of your deposit products."

- They're not intense investors and do not follow the stock market carefully.

- They're usually not detail-oriented money managers. In Hudson's institution, there seems to be a high correlation between profitability and people who don't reconcile their checking accounts, he says.

• Lifecycle events such as saving for retirement and setting up college funds also seem to be reliable profitability indicators, Hudson adds.

CHANNEL SURFING

First Manhattan's research also shows that delivery channels are related to profitability:

• Self-service customers — They do not use branch services. They account for about 10 percent of the customer base, 20 percent of the profits and 5 percent of the expenses.

• Mixed channel users — They use all channels — including the branch, the ATM and telephone — and account for about 50 percent of the customer base, 20 percent of the profits and 65 percent of the expenses.

• Branch-only users — They account for 40 percent of the customer base, 60 percent of the profits and 30 percent of the expenses.

IMPLICATIONS

Hudson and others say the First Manhattan study and similar examinations of customer profitability have several implications:

• Pricing — Product distribution expenses should be factored in to determine what products really cost.

For example, low-profitability households — particularly the bottom 20 percent — have inordinately high transaction levels and relatively low balances.

"I envision a pricing scheme where we charge certain people for ATM use beyond a certain number and telephone use beyond a certain number," Hudson says.

• Cross-selling — Since profitable users of one product are likely to be the profitable users of others, community banks should — instead of trying to sell everybody everything — focus cross-selling efforts on profitable customers.

"About 50-60 percent of all the cross-selling we're initiating in the bank is creating more burden than value. In some institutions 80 percent of the cross-selling activity is unprofitable," Hudson says.

• Advertising — Mass-media bank advertising that sells to the general public should be switched to more targeted tactics such as direct mail.

• Branch elimination — "Many high-profit households are branch-wed. So as we begin thinking about doing away with the branch or eliminating branch services, we need to be very thoughtful and very careful," Hudson says.

• Customer-service surveys — Surveys should be coded according to the level of profitability — top 20 percent, middle 30, lower 50 — giving more-profitable customers' forms higher value or more votes.

Hudson stresses that he is not suggesting that low-profitability customers be driven from the bank.

"What we're going to do is find alternative products and services that either encourage more revenue, or require less expense to serve these customers," he says.

Appendix B

SERVICE LEVELS

Community banks should maintain 100 percent quality service for everyone, but "we have to think about what we can do to improve our levels of service for our most profitable customers," Hudson says.

Simple things help:

• Give them a special telephone number to call your service center and talk to highly trained people.

• Use a laptop computer to bring bank services to their homes, suggests Lance Kessler, SVP and marketing director, Keystone Financial Inc., Harrisburg, Pa.

• Send thank-you notes and occasionally call to inquire if they're satisfied with the bank's service.

Says Hudson: "What we need to do is take the time and investment to better understand the profitability of our customers, how they use our services, how they use our products — so that we can be more intelligent identifying those segments we want to continue focusing our efforts on."

BY PATRICK DALTON